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Toronto Office

The Province of Alberta

IN THE MATTER OF "THE NATURAL GAS UTILITIES ACT"

—and—

IN THE MATTER OF an Enquiry into Scheme to be adopted for Gathering, Processing and Transmission of Natural Gas in Turner Valley

G. M. BLACKSTOCK, Esq., K.C., *Chairman*

Dr. E. H. BOOMER, F.C.I.C., *Commissioner*

Session:

CALGARY, Alberta April 17th, 1946

VOLUME 78

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A.M. SESSION

Wednesday,
April 17, 1946.

MR. FENERTY: Mr. Chairman, if the Board pleases in connection with the cross-examination of Mr. Mercer, Mr. Steer, Mr. Chambers and myself have been discussing the matter and a suggestion Mr. Steer has made would seem to be an admirable one and which I understand Mr. Chambers raises no objection to is that we might have Mr. Hamilton take the stand and give us the result of his analysis for the 1943 operation. We will perhaps want an opportunity of looking at the statement in advance because it will shorten the cross-examination if there is going to be cross-examination. That should be coupled with Mr. Mercer taking the stand. It will not be necessary for him to produce any of these books and other records but he should take the stand and we can ask him with reference to these particular statements referred to in the evidence. Whether he has searched for them and what happened to them and if he has them and can produce them. We will limit it to that. If they are not there, we do not propose to delve into the books. That will not be a very lengthy process.

MR. CHAMBERS: So far as Mr. Hamilton giving you that evidence is concerned, I am not objecting to it but I am claiming it is irrelevant. But let it go in.

Now you recall I filed as Exhibit 169 the balance sheets of the Gas Company for the years, I think 1938 to 1944 inclusive. I now have a copy of the 1945 balance sheet and I would like it to be added as part of Exhibit 169.

THE CHAIRMAN: All right. Mr. Scrimgeour.

HENRY B. SCRIMGEOUR (Recalled)

THE CHAIRMAN: Mr. Chambers, you had an unanswered

MR. [illegible]: Mr. Chairman, if the Board please, in

connection with the cross-examination of Mr. Sawyer, [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

as the result of the analysis for the 1962 operation. [illegible]

will [illegible] opportunity of looking at the statement [illegible]

[illegible]

[illegible] Then [illegible]

[illegible] the stand. It will [illegible]

necessary [illegible]

[illegible] the stand and we [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible] it will be a very lengthy process.

MR. [illegible]: [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

THE CHAIRMAN: All right. [illegible]

[illegible]

question when we adjourned yesterday.

Q MR. CHAMBERS: Oh yes. I do not think that I am interested in any wells in that area and I just raised the point yesterday, Mr. Scrimgeour, that assuming the Board was to fix a well-head price for the wells connected to your Company's system, what would be the position of your company then as to gathering charges and the other matters that are covered in your Exhibit 171?

MR. FENERTY: I wonder if my learned friend would clarify that question just a little longer. Is he talking about the well-head price for dry gas?

MR. CHAMBERS: Yes, the well-head price for dry gas.

A The well-head price for dry gas, Sir, would mean that we would have to recompense ourselves first for the gas gathering charges and then pay your Company for the transportation to the Absorption Plant depending on the price that is set, Sir.

Q Well let me put this to you, Mr. Scrimgeour, as a hypothetical case. Assuming that the Board is to fix a maximum price to be paid by the Gas Company for Turner Valley gas downstream from the Madison Scrubber and also assuming that the Board says that every thousand cubic feet of dry gas at the well-head is to carry a certain price to be paid to the well owner. Now then as between the well-head and the Gas Company's intake there is the process of gathering the gas in your area by your Company; then there is the process of bringing it from your plant to the Madison Scrubber; there is the process of scrubbing it. Now what remuneration, or on what basis would your Company expect remuneration for its gathering of the gas, of that dry gas? Have you given any thought to that?

A I have not, sir, because no rate having been set either at the well or otherwise we have not explored that avenue at all.

I do not think I would be prepared without further thought to answer except to say that our Company would be certainly agreeable to sitting down with your Company and coming to an amicable arrangement.

Q Bear in mind it is not a matter of concern as between your Company and our Company. That is a matter that the Board has to deal with?

A Yes.

Q Or may have to deal with. You tell me that you have not given it thought?

A I have not, sir, given that any thought at all. We have no knowledge of where the rate is to be set, at what point, and therefore have not explored that avenue.

MR. FENERTY: May I ask a question?

THE CHAIRMAN: Yes.

....

CROSS-EXAMINATION BY MR. FENERTY.

Q Mr. Scrimgeour, do you get any dry gas at the well-head in any of the wells connected with your Plant?

A In my estimation, no, sir.

Q As far as you are aware, where does this thing we call "dry gas" first appear?

A At the Absorption Plant, out of the outlet of the Absorption Plant.

Q And that is the basis you have made your submission on here?

A Yes.

....

CROSS-EXAMINATION BY MR. McDONALD.

Q Mr. Scrimgeour, we will deal with Schedule "A" in your No. 1 Submission, Exhibit 171. Am I right in assuming that the

General Appraisal Company Limited purported to make the appraisal on the basis of reproduction costs new as of September 21st, 1942? Is that the basis?

A Not "new", Mr. McDonald. Reproduction Costs less depreciation, use and obsolescence. 30% is shown as the deduction on that ground.

Q Yes but their gross figure was on the basis of Reproduction Costs New. I mean their gross figure and then they took that off?

A Correct.

Q Now can you tell me what types of pipe are comprised in this footage of 174,019 feet. What I mean is this, is it welded pipe? Have you any idea of that? Is it screwed?

A I am afraid, Mr. McDonald, I cannot answer that question. It is three years since I was down at the refinery at Hartell. I never saw the pipe. The invoices going through probably show that, but it is many, many years ago and I have completely forgotten.

Q Do you suppose there is a record, the working papers for instance, of the General Appraisal Company which will show whether the pipe was welded or screwed?

A Yes.

Q And the size and weight?

A Yes. Their Volumes 1 and 2 show the complete details. That would be available.

Q The reason I ask you that, Mr. Scrimgeour, is this, that there have been appraisals made of other parts of equipment in the field and I notice that in the pipe with the greatest length laid, namely the 4-inch pipe, the price of the appraisals that have been made are $1.28 a foot as against your figure of $1.89 plus 24 cents. I mean that makes a

difference in the gross valuation . . . . .

A What is the 24 cents?

Q The 24 cents, that is trenching.

A That is not pipe?

Q No, I am saying my figure of $1.28 includes trenching and ditching and the laying of the pipe.

A Are you allowing my deduction of 30%?

Q Oh yes. This is prior to any deductions at all.

A That brings it down approximately, 30% . . . . .

Q My figure of $1.28 is the gross figure, not allowing for any depreciation. That makes a very considerable difference in your valuation?

A Well the basis of the General Appraisal Company was Reproduction Costs at the date of the appraisal taken from invoices and catalogues surrendered at the time to this appraiser and as we believed they were correct at that time. Allowance was made for obsolescence, depreciation, etc. by the 30%.

Q Well now, how did they arrive at this 30% depreciation. Was that observed depreciation?

A Yes, I think you would call it observed depreciation.

Now do you know how much of this pipe was new to start with or was some of it purchased second-hand?

A You are asking me, Mr. McDonald, to go back to 1934 and I am afraid I cannot answer that conclusively. Some of it was new and some of it was used pipe.

Q Would that be shown in these particulars of the General Appraisal Company?

A They had no knowledge of the date of the purchase nor who it was purchased from. It was underground. He never saw it.

Q So this figure of 30% is an assumed figure?

A An assumed figure, yes.

Q The appraiser thought from his experience it would be a reasonable allowence?

A Yes.

Q Mr. Scrimgeour, can you provide us with the particulars, the working papers of the appraiser so that we could investigate the comparative prices between the appraisal made of the Madison system and of the appraisal made of this system?

A It would be hard to put in as evidence three volumes. . . . .

MR. MAHAFFY: On that point, Mr. Chairman, I am sure we will be glad to give Mr. McDonald any information we can but frankly we do not intend to produce all the working papers of the appraiser.

THE CHAIRMAN: Do you have them?

MR. MAHAFFY: I do not even know if we have got them.

THE CHAIRMAN: I would be very surprised if you did.

A We only have the final volumes.

MR. MAHAFFY: We have the Reports which are in two or three substantial volumes.

THE CHAIRMAN: I imagine the appraiser kept his own working papers. I would think he would.

Q MR. McDONALD: Maybe I can look into what they have and if I require any further information I will look it up again. Now can you tell me how much gas was actually passed through this sytem prior to September 21st, 1942. How much gas?

A Well, Mr. McDonald, as I explained yesterday, this submission is from Gas & Oil Refineries Limited, which is a new incorporation and a new group of shareholders. Mr. Mayland's organization will make no objection, I understand, to submitting the historical costs and throughput or any other information. But this submission today or yesterday is entirely from Gas & Oil Refineries Limited of which I am the accountant.

Q I think Mr. Hamilton has the figures I was looking for. I notice in his statement here. Would you tell me what are these domestic gas lines you refer to here that is being included in the gathering system?

A We have approximately 75 homes adjacent to our Plant which have always been allowed to obtain their domestic gas from us and formerly I think a small charge was made and it was finally stabilized at the average rate of $3.00 plus sales tax, making $3.24. These lines are lines that service the homes adjacent to our refinery.

Q Those are the lines then that comprise the 32,850 feet at a net valuation of $20,242.73?

A Correct.

Q That is not a question of gathering gas for the . . . . . . That is purely a question of distribution?

A Purely a question of distribution, yes.

Q In other words, that system is in the same category as the Valley Gas Company's lines in Turner Valley town for instance?

A Yes.

Q THE CHAIRMAN: And your figure of $20,242.73, although for gas lines would only be relevant in an Inquiry if you inquired to fix the price of gas for domestic consumers?

A That is correct, sir. In preparing this submission, sir, might I state that our Company is trying to abstract from the records the cost of operating a small portion of a small unit of a refinery and I have had to go down the line in order to extract these costs and in our own operations we operate under combined operations and we do not make these break-downs in my own books. The closest break-down I can get for operating was gas lines, whether dry gas distributing lines or wet gas gathering. I therefore included the whole

thing in the one operating statement.

Q MR. McDONALD: Dealing with the reserves, Mr. Scrimgeour, as I understand it you took Table 5 of the Report filed as M3?

A Correct.

Q And Column 3, which gives you, it was according to this column that it gave you the 37 billion cubic feet?

A Yes, I had to build back, Mr. McDonald. If you will notice that commences I think in 1944 and I had to go back nine months to April 1st, 1943 and by straight calculation, by adding back, I was able to arrive at what the reserves would have been on that date and they carry on down comparable to the table of the Madison Natural Gas Company.

Q Now that 37,298,310,000 cubic feet - that would be cubic feet - but some of it would be marketed as dry gas and some would be used in the Absorption Plant?

A Yes.

Q And some would be used in the refinery and some would be flared?

A Correct.

Q So that in calculating your operating costs per M.C.F. in Schedule "C", you have based it on your wet gas at the entrance to the Absorption Plant.

A Correct.

Q And this figure per M.C.F. in cents would be applicable then to the four categories of gas you mention?

A That is true.

Q Now there are in effect only three markets out of the four categories you mentioned. That is the Absorption Plant and the volume it extracts; the market for dry gas to the Madison system and the refinery system, that is supplying Gas & Oil

Refineries?

A Yes, and a small quantity for the domestic line.

Q And therefore the fourth category is the flared gas. Have you given any thought as to where you apportion the cost of gathering that?

A Of gathering the flared gas?

Q Yes.

A If you notice, Mr. McDonald, in this costs sheet this is based on wet gas?

Q Yes.

A We claim there is no dry gas until it leaves the Absorption Plant.

Q All right. Then would you just tell me this, Mr. Scrimgeour. You mention in paragraph 9, page 2 of Exhibit 171 that you have a revenue from absorption gasoline. Now what is it you call absorption gasoline?

A That is the recovery from natural gas through the process of absorption.

Q Yes. Now then you have a second category. High vapour pressure gasoline. What is the difference between the two?

A That is a second grade unit attached to the Absorption Plant called the iso-butane - pentane unit in which the gas is further processed and we recover the pentanes and the highers and they are sold to the Royalite Oil Company at the present time. During the war they went to the Imperial Oil Refinery for making the alkylate for aviation fuel.

Q Now just to try to get it down to my way of thinking of this Plant. The absorption gasoline is what you take out in the first plant?

A Correct.

Q Is that what we call the 26 pound product?

A Yes.

Q Then you continue the process into the second plant and it is from this plant that you get the high vapour pressure gasoline?

A Yes, the iso-butane - pentane unit, sir.

Q Do you sell these two products combined?

A Yes, that is one product. It comes out as one product. Now pardon me, do you mean the iso-butane as separate from the iso-pentane?

Q Yes, do you sell them separately?

A No, they are combined, resulting in a vapour pressure of approximately, I think, 46 R.V.P.

Q MR. STEER: Do you sell both the 26 pound and the 45 pound products? Do you sell both of them?

A No, sir. Gas & Oil Refineries in their refinery blending use the 26 pound vapour pressure and we sell the other vapour pressure to the Royalite Oil Company. We are different from the other Absorption Plants in that they only make one and that goes through the pipeline to the Imperial and the B.A. Refineries and they make their own blends themselves and we make it at our own plant.

Q MR. McDONALD: Your explanation to Mr. Steer is the opposite to what you mentioned to me.

A No sir. Pardon me, I said did you mean the difference between iso-butane and iso-pentane?

Q Oh no. I mean the difference between the 26 pound product and the other.

A Oh I misunderstood you. The 26 pound product is used in our own blending operations, the Gas & Oil Refineries Limited. The other recovery which we call "high vapour pressure

gasoline", originating from the iso-butane - pentane unit is sold to the Royalite Oil Company.

Q That is something we can deal with when we deal with Submission 2?

A Yes.

Q Now if I can just deal with paragraph 9 with regard to the allocation of costs of the gas gathering system. Am I right in understanding you yesterday that your proposal is that the gathering costs or that all of the products of your Plant, that is the Absorption Plant, and the high vapour pressure Plant and the dry gas be sold for value?

A Correct.

Q And that the costs incurred in getting the products to the Plant, processing it, be calculated at say 80% of the value and that you would then pay 20% to the man who provided the raw material?

A Yes.

Q And that in that 80% you would absorb, the Plant or operator would absorb the gathering costs?

A That is correct.

Q Now did I understand you yesterday to say that you realized that your gathering costs as indicated by your submission would be out of line, that is much higher than the gathering costs of the system handling a great deal more gas?

A That is so, sir.

Q And that you would accept as a measuring rod for your value for gathering costs in your submission the costs of say the Madison system, the largest system in the field doing similar work.

A Yes, that is correct. I intended, Mr. Chairman, to correct an impression left yesterday when in answer to Mr. Steer, he

made almost the identical statement that Mr. McDonald has made, that we realize that our costs are higher than the other absorption plants because our throughput is only approximately 15% of its normal capacity and it was not the intention of our company to put in a submission at the start. We felt that our small operations would be probably of no interest to the Board and that we were prepared to accept the rates that the Board should set, based on the figures submitted by the other companies which comprise approximately 90% of the gas in the field. However, we have made this submission, sir, but we do not ask that the basic rate be set on these figures. We have submitted them to the Board as a help in arriving at the costs that they will have to determine.

Q THE CHAIRMAN: In other words, your submission goes to this extent, you say "We are prepared to accept whatever amount is given to Madison and in order to establish to the Board that is not an amount greater than we are entitled to, we produce this submission."

A That is correct, Mr. Chairman.

(Go to page 6281).

Q So we have arrived then at this stage then Mr. Scrimgeour, that we have the cost fixed at whatever Madison - just for illustration I will refer to Madison - and possibly that will be the cheapest, the lesser gathering cost in the field. Now then does not the problem then arise as to whether that gathering cost should be apportioned as between the absorption plant operation and the dry gas operation. We have the amount fixed. Now the question -

A That is the amount for dry gas ?

Q No, for gathering the gas as a whole.

A We do not know that that is going to be the basis of the rate.

Q No, we do not know because an order has not been brought down, but just for an illustration we will say that the gathering costs are fixed at two cents per thousand cubic feet for your illustration of wet gas gathering basis. Now that wet gas has resulted in two products, the dry gas which has been sold to the market and the absorption gasoline which has been sold in another market. Now how should the two cents be apportioned between the two uses of the gas. That is the problem we still have.

A Well if I get you correctly sir, this rate that you are assuming is fixed at say two cents is the cost of transporting wet gas from the wellhead to the absorption plant.

Q That is true, yes.

A Therefore the revenue would all go to the absorption plant if it is a recovery of cost. And, any excess over the portion that finally reaches the market would be the well operators portion. On that basis it would be nothing. In fact the well operator would owe us money.

Q Yes. I appreciate that statement, but what I am trying to get

at finally is this, if you do not apportion some costs to some portion of that two cents to dry gas, how are you going to arrive at a price for the dry gas that you are going to sell at the absorption plant outlet.

A Well we are not attempting, Mr. McDonald, to arrive at any price for dry gas. We are willing to accept the price that the Board are able to give to us.

Q Well then how is the Board going to arrive at a price if they have not some idea of the cost of gathering ?

A We are getting into an argument on economics as I understand it. There are two methods of costs. One is the old George Adam Smith of supply and demand which an ordinarily competitive business applies. But, in a public utility, sir, you have to also take into consideration the cost of the utility that is furnishing or supplying the utility being sold and your prices are therefore somewhere between these two brackets. Now my stand is we are selling dry gas and that we are out to find the highest market. At the moment the only market is the City of Calgary which is now the whole system as a public utility, and we have to abide by this Board's decisions as to rates. After that rate is set then we are in a position to allocate our costs. If our costs are too high then we close up the plant. We do not know.

Q The point that is interesting me is to ascertain from you if you can assist the Board in this problem. If you do not provide the Board with the costs, the figures, showing the cost of gathering and apportioning some of it to dry gas, the Board cannot do its duty in dealing with a utility product such as gas, of making sure that the adequate cost has been taken care of.

A Mr. McDonald, you are trying to force me to an admission that I do not agree to. There is no dry gas being transported. Therefore there can be no allocation of costs. There is wet gas being transported. In other words we claim and maintain that there is no dry gas at the wellhead. The dry gas is a product or co-product of the absorption plant. Might I use an illustration sir. We can take sawdust as being a by-product of the sawmill and you cannot say that there is so much sawdust in a tree. Or, take a packing plant for instance with the hides. In the process you can get so much beef. We find that the hide is not given back to the farmer. However it costs nothing. The farmer sold a steer. He did not sell a hide. He sold the whole thing as one unit. There was no hide until it left the packing plant. There is no dry gas until it leaves the absorption plant. That is our stand in this matter.

Q But your simile is not applicable here because under your contract the producer does not sell his dry gas. It is a marketable product exclusive to the absorption gasoline is it not ?

A True, originating X the absorption plant, not before.

Q Now then your situation is this, that you will bring us in figures in your submission No. 2 which show that your absorption product itself does not take in from the posted field price, does not pay the cost of operating the absorption plant ?

A That is correct.

Q Now you have a by-product, you call it that for the moment, which you can now sell in a market which we will say has been given to you. Now are you suggesting therefore the question of gathering costs should not enter into the fixing of the price of the by-product which you are now able to sell, the by-product ?

MR. MAHAFFY: I wonder if my friend would split that up. There are about three questions in there. The first part of

the question the witness may want to answer one way or the other but he may not want to include an admission that the product was given.

A I think I can answer this way, that we have taken them into consideration in suggesting an 80/20 split.

Q MR. McDONALD: But I am not worrying about the 80/20 split. How are you going to fix the price of gas at the outlet of the absorption plant ?

A You mean how is the Board going to fix the price ?

Q Yes. Are you going to ask the Board to supply you with the entire deficit in operation of the absorption plant up to that date or are you going to say you will take so much ?

A No, I have very clearly made that in my submission that I recognize our costs are high and we are prepared to accept the rate that the Board arrives at by using the other Companies who have 90% of the product for sale. In other words, Mr. McDonald, we wish to place our contract well operators in exactly the same position as if they were attached to either of the other plants. We wish to give them every benefit and treat them in exactly the same way.

MR. STEER: In other words, your prices are to be fixed on the rate bases of the other two Companies.

MR. CHAMBERS: I would like to know clearly whether Mr. Scrimgeour's last statement is applicable both to the wet content and the dry gas. In other words whether you are putting the well owners in exactly the same position as a well owner connected to the north end of the system.

THE CHAIRMAN: I can see where there is some confusion in Mr. Scrimgeour's mind. If you would explain to him, Mr. McDonald, the basis on which the wellhead price is to be fixed,

that is to be fixed for the gas from the wellhead, but not taking into consideration the gasoline fraction contained in it, then he will realize that there is a separation at the wellhead.

Q MR. McDONALD: Maybe I should go into that. Mr. Scrimgeour it might be the authority the Board was fixed under the Act and is to fix the price of the gas at the wellhead excluding therefrom the hydro-carbon content which is extracted by processing, and the problem the Board has is to fix a price at the wellhead or at the dry gas base at the end of the absorption plant. But if it does it must take into account all costs incurred between the two points. Now if the price is fixed at the wellhead.

(Go to Page 6286)

MR. FENERTY: Before my learned friend proceeds with that, I would like to know if that is a hypothetical question or a statement of what the Board must necessarily do?

THE CHAIRMAN: I think Mr. McDonald is paraphrasing the section of the Act. That is what he is doing.

MR. McDONALD: Yes.

MR. FENERTY: That the Board may do?

THE CHAIRMAN: Yes, certainly.

MR. FENERTY: You will remember that our friends were instrumental in having the obligatory part struck out, what the Board may do. The Board can do it at the place where you find it, not the place where you do not find it. I do not think we should proceed on the assumption in advance that the Board is going to fix something at an artificial place, some place where you do not find the animal. If my learned friend is putting it on that basis, that he may do that and it is reasonably logical and that he is just discussing a hypothetical question, well and good. But I would suggest that he put it on another basis fixed at the place where you find it.

THE CHAIRMAN: Well, we have spent a lot of time in trying to find a basis of cost allocation of the transportation of the gas from the well head to the absorption plant, and we have had different theories advanced, cost realization being one, or sales realization being one.

MR. FENERTY: I do not want to be in the position that all of us here accept it and take it for granted that there might not be any argument on the question whether it should be fixed from the place that he was assuming by everybody, that was all.

THE CHAIRMAN: Well, Mr. Fenerty, this much is clear

that the gas has to travel from the well head to the absorption plant. Now, should the absorption plant bear all of the cost or how should it be divided between the natural gasoline and the ultimate dry gas? That is the problem.

MR. FENERTY: You see, of course, what we say is this, that as a result of an absorption operation we get an inferior product for heating purposes. It appears as an inferior product nearer the place where it will be consumed. We, in all seriousness, are going to suggest that you should not impose all the obligations on the consumer. As a result of the gasoline extraction, you get a product with a lower B.T.U., I think the evidence is, less heating units, and it appears as an inferior product, and, with some compensation, you get it nearer to the place where it is to be delivered. These are the various things you have to take into consideration.

Q THE CHAIRMAN: Well is the matter completely and fairly clear to you, Mr. Scrimgeour? From all the discussion we have had?

A Yes, I think I see what Mr. McDonald is getting at, but until that rate is fixed, I could not start to make an allocation.

Q MR. McDONALD: I just point this out to you, that if gathering costs, or if an allocation is not made, it may be that gathering costs in your system will be charged as a cost against the producer and deducted from his well head price. On the other hand, if the allocation is not made and an arbitrary price is fixed at the outlet to the absorption plant, the consumer may pay more on account of gathering costs than the service which he is receiving. That could arise, could it not?

A That could arise.

Q Under this type of approach that you have as to costs, Mr. Scrimgeour?

A That could arise.

Q THE CHAIRMAN: Another way of putting it is, that if the Board fix a rate of X cents for transporting gas from the well head to the absorption plant, how would you divide that X cents between the absorption product and the resulting dry gas?

A Yes, that is the problem, sir. Well, I have given it no thought. We are waiting until the rates and the methods are fixed and then we could approach the subject. I have given it no thought, Mr. McDonald.

Q MR. McDONALD: Then the conclusion you set out in Paragraph 9 is not your final conclusion in regard to that?

A No. It was a suggestion to the Board. We have been discussing it and I have been wondering whether I should read it again, or is that necessary?

Q Yes, you can read it again.

A It was a somewhat novel approach, but I understand it is fairly sound in principle. Paragraph 9 of Report No. 1 is as follows:-

" Our opinion has been requested as to the apportionment of total Wet Gas Gathering Costs between Absorption Plants and Residue Dry Gas. In our opinion the total costs of gathering wet gas should be included as part of the operating costs of the Absorption Plant and the Revenue from the sale of residue Dry Gas should be added to the revenue derived from the sale of abs rption gasoline, High Vapour Pressure Gasoline and any other By-Products which may be now or hereafter recovered

"from Wet Gas. The product transported by the Gas Gathering Lines is a mixture of Dry Gas and Casinghead Gasoline and it is only after this mixture has been processed by the Absorption Plant that these component parts are separated. Total costs of operating the Absorption Plant and maintaining the Gas Lines are recoverable from the revenue derived from the sale of all products contained in the Wet Gas and we can see no advantage in complicating monthly calculations to apportion relative costs to separate revenues, as the same well operator receives his share of all revenues, whether on an 80-20 basis or such other basis as may be determined by the Board."

In other words, Mr. McDonald, you, as a well operator, are going to get the revenue from the absorption gasoline, high vapour pressure gasoline and also dry gas. Now, then, the allocation of costs, one to the other, in my way of thinking does not make much difference. Your cheque will be so much money and it will be of very little interest to you whether I have taken off so much off this portion and so much off another. The same answer will be obtained.

Q Well, that would be so, provided that in the sale price of dry gas a proper proportion of the gathering costs have been included over and above the well head price, am I not correct in that?

A Yes, that would be so.

Q So that the problem you are relegating to the Board, is the problem of determining what the gathering costs applicable to dry gas should be allowed as part of the sales price of the

absorption plant.

A That is so.

Q And you are not going into the theory of how that should be done. Now, Mr.Scrimgeour, you refer in Paragraph 10 to the Natural Gasoline Association of America agreement whereby the revenue for the sale of dry residue gas is divided on a 50-50 basis between absorption plant and well operator. Now, you refer to the standard form of contract?

A Yes, that is correct, Mr. McDonald.

Q Now, do you know the basis of arriving at that 50-50, or the reasons for arriving at that 50-50 basis?

A Experience over the number of years that the absorption plants have operated in the United States.....

Q Yes?

A ......resulted in, I suppose you would call it an arbitrary division of 50-50, or an admission on the part of the Association that it is almost impossible to allocate costs.

Q Now, do you know if the gas is gathered prior to this 50-50, the gas is gathered and this is the sale at the outlet to the absorption plant which is divided?

A Yes.

Q I suggest to you that the price at which the gas is sold, then includes in it a proportion of the gathering costs?

A Oh yes, it must.

Q It must?

A Yes, it must.

Q And what has been done is that the 50% which the absorption plant receives covers the gathering costs and covers a commission on a part to the absorption plant?

A It should cover the gathering costs, put it that way.

Q Yes. Now then, do you know whether that contract is entered

into where there is an actual market for dry residue gas in existence prior to the contract being entered into?

A No, we did not explore that. We simply asked for and obtained a copy of their standard contract. Mr. McDonald.

Q Then I suggest to you that that contract is a contract made between absorption plant operators and producers where there is no fixed market, no steady and ascertainable market, and the price for the dry gas, the market has to be discovered by the absorption plant?

A I could not accept that. No contract would be entered into unless there was a market available. There would be no purpose in establishing a contract unless a market was available.

Q Well, isn't this so, that absorption plants are often directed to treat gas prior to a market being found for the dry gas, as their consideration is to get the absorption gasoline?

A Yes, that is true.

Q And if they find a market for the dry gas, that is an additional revenue for the plant and the producer?

A That is correct.

Q And I just suggest this to you, that no producer would make that type of contract unless he could sit down and know what the price of the dry gas is going to be, and at the same time sit down and know what the gathering costs were going to be. He would only make such a contract when those things were all certainties at the time that he made the contract?

A Not necessarily, Mr. McDonald. He might be glad to find the extra revenue derived from the 50%.

Q Just to illustrate what I have in mind, say there was a fixed market for all the gas in this absorption plant going into the absorption plant of 5 cents, and the gathering costs of getting the gas from the well head to the absorption plant was 1 cent.

Now, you wouldn't suggest that the producer would make a contract with the absorption plant operator and he will allow the gas to be sold for 5 cents and allow the absorption plant $2\frac{1}{2}$ cents for the gathering, leaving only $2\frac{1}{2}$ cents for the value of the gas?

A I think he would be very wise to enter into a contract like that. It is found revenue.

Q Well, why shouldn't he hold out for the full value of his gas at 4 cents, because that is what it is worth?

A Well, again of course, the law of supply and demand comes in.

Q Well, I am saying there is a fixed market, the demand is there?

A If he is not willing to accept this contract, he has an alternative, he can build an absorption plant himself.

Q Or he can sell to another absorption plant?

A If there is another market, true, he has that advantage, Mr. McDonald.

(Go to page 6293.).

Q And if because the Public Utility Commissioner or the Board should direct would it be proper for the Board in your opinion to say to the producer: "We know your gathering costs are only one cent but we are going to tell this Absorption Plant to take $2\frac{1}{2}$ cents and only give you $2\frac{1}{2}$ cents for the gas which costs indicate should be 4 cents, with 4 cents to you."

A I do not know how to answer that.

Q Is not that the problem we are forced with where there is a market already established?

A I can answer it best by saying this that we expect the Board to take all these things into consideration in fixing their price.

Q And if the situation is as my hypothetical proposition that I put to you, the Board would be fully justified in fixing the proportion at one out of five to the Absorption Plant and four out of five, that is 80% to the producer. As far as the dry gas content is concerned.

A You said they would be justified in doing that?

Q Justified in doing so on my hypothetical proposition.

A Would you mind repeating that.

Q On the supposition that 20% of the price pays the gathering costs, then 80% of the price of the dry gas should be paid to the producer.

A In other words, a reversal of the abosrption plant situation.

Q Nothing to do with the Absorption Plant. You are asking us to adopt the 50-50 price because that is a common type of agreement.

A Common practice, yes.

Q In the United States. Now would not you, if there is an exceptional situation, there is an established market and the gathering costs are 20% only of that established market price,

there is then no basis for any Board to direct other than a 50-50 disposition of the proceeds.

A No, I am afraid I am supposed to say - I mean I must answer "yes" to that on account of your premise that the Board has already divided the gas at the well-head under two component parts.

Q So that the suggestion you make in paragraph 10 of adopting this Natural Gasoline Association of America basis really is not applicable to our situation here. We have the known facts here. We have an assured market for our gas. It is not a question of negotiation as between the absorption plant operator and the producer. It is a question of the price being fixed.

MR. CHAMBERS: I would like to know whether you are putting it as a statement or an assumption to this witness that we have an assured market.

MR. McDONALD: I will have to put it as an assumption. I suppose there is nothing certain in this world. We have as assured a market as can possibly be assured in any business.

THE CHAIRMAN: For the next few months, yes.

A The other assumption, Mr. McDonald, is the rate. We do not know that the rate will be sufficient to cover the cost. You see your questions to me are, most of them, suppositions and I am trying to answer as best I can, sir. It is rather hard to base answers on suppositions.

Q MR. McDONALD: What do you mean?

A The rate that might be set by the Board might not be sufficient to cover our costs of gathering.

Q That creates a problem . . . . .

A We hope they will but we do not know.

Q So are you suggesting then in this submission that your costs of gathering are as set out in Schedule "C"?

A That our costs are which?

Q That your gathering costs are fairly estimated in Schedule "C" of Exhibit 171?

A Yes, they are accurately estimated but we are not asking the Board to set a rate based on those figures. We submit them as evidence to assist the Board in arriving at their rate.

Q Now that raises a question, Mr. Scrimgeour, of this transaction between Gas & Oil Products Limited and Gas & Oil Refineries Limited. As I understand it, they are two different sets of shareholders?

A Completely, yes.

MR. McDONALD: Mr. Chairman, I would reserve my cross-examination on that point until I have a chance to hear Mr. Hamilton's evidence on historical costs. I understand by his statement here he is going to put in considerable information.

THE CHAIRMAN: Have you any questions to ask, Mr. Hamilton?

MR. HAMILTON: Yes.

....

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. HAMILTON.

Q Mr. Scrimgeour, in the first paragraph of your statement contained in Exhibit 171 I draw the inference that you consider that your operating costs per M.C.F. would be considerably higher than that of other operators?

A That is correct, Mr. Hamilton.

Q Have you had an opportunity to examine the submissions made by the Madison Company for example with respect to the estimated costs of wet gas gathering and wet gas

compressing as contained in Exhibit 81, Schedule "M-12-D'.
I do not suppose you have?

A No, I have not.

Q I refer you to that particular submission. For the benefit of counsel, it is Schedule "M-12-D" on page 1 of Exhibit 81 in which the total 1944-48 gathering and compressing wet gas costs are stated at $2,354,249.31 to be applied to a volume of 79,688,956 M.C.F., resulting in a cost per M.C.F. of 2.95 cents. Now I am suggesting to you that that figure of 2.95 cents per M.C.F. is the cost as estimated by Madison on a wet gas basis, assuming a rate base for the gathering system determined on Reproduction Cost new, less observed depreciation basis and assuming as from the inception of regulation a throughput formula for depreciation and assuming an allowable rate of return of 15.833%. In other words substantially speaking the method of calculation, the method of determining the unit costs as contained in this Madison submission to which I have referred you is substantially the same as that which you have applied in preparing Schedule "C". Now what I am getting at is this. When you speak of your gathering costs being high relatively speaking in paragraph 1 of your Report, are you considering the subsequent costs of transmitting the G. & O. R. gas as an element of the ultimate gathering costs or were you considering your costs of gathering would be naturally higher than anyone else's?

A I simply assumed, Mr. Hamilton, that because our throughput was 15% of the normal capacity that our costs would be higher, assuming that the other plants were operating at or near the maximum. I have no figures to prove whether they were or not.

MR. CHAMBERS: May I interject? Does not that figure you mention of four and a fraction, is not that the average

costs for getting it to the scrubber and compressing unit? I just want to be clear about that.

THE CHAIRMAN: It includes compression.

MR. CHAMBERS: It includes compression and up to the scrubbing plant?

Q MR. HAMILTON: That would be correct and in order to reduce it to a straight gathering cost, you can divide it roughly in half I take it. Would you agree with me in this, Mr. Scrimgeour, that if your costs are below that of other operators, the method of determining that cost becomes very important.

A If we are below, sir, yes it does.

Q I believe you said to Mr. McDonald that you felt the producers should be treated alike irrespective of what system they happened to be connected to?

A I did.

Q Would that mean to say in your view that a producer connected to your system should receive the same price per m.c.f. of dry gas to deliver to the market as they receive if the operator were connected either to the British American or to the Madison system?

A That is how we feel?

Q Would you consider this proposition from the viewpoint of the consumer, he should pay the same price per m.c.f. for gas irrespective of which system it was fed into?

A Yes, I would say yes.

Q And would you say that those two propositions are essentially irreconcilable?

A That is that the consumer should pay the same price and that the well operator should obtain the same return?

Q Bearing in mind that the cost of delivering the gas from

the well-head to the market is bound to be different in the three systems. The terminal price and the originating price cannot be the same. One or other must vary.

A The statements are not irreconcilable, however. You treat the Turner Valley field as one field.

Q Let us examine that proposition a little more carefully then. The gas that enters the Madison system is gathered, compressed and goes to the scrubber. Gas which enters the G. & O.R. system is gathered and turned over to the Madison Company for delivery and through the British American line and then transported in the British American line to the scrubber. It would be a matter of coincidence if the cost of compressing and transmission through the Madison and B.A. lines of your gas would be the same as for the Madison gas coming from crude producers?

A But they are not the same. I am not claiming, sir, they are the same.

Q If producers are to be treated alike in the sense that they get the same well-head price per M.C.F. on a dry basis, then the consumer is bound to be paying a different price for the two types of gas.

A I cannot follow you that he would pay a different price for the two types of gas.

Q Well, if you will assume that the consumer is to pay the well-head price, whatever that is, and to bear the cost of delivering the gas from the well-head to the market, you will assume that?

MR. MAHAFFY: Mr. Hamilton, who do you intend when you say "the consumer"? The Gas Company or the consumers in Calgary?

MR. HAMILTON: The Gas Company will suffice.

Q I am suggesting to you that the Gas Company will be paying a different price for gas which originated in the G. & O.R. system as compared with the gas which originated in either of the other systems. Well perhaps we can leave it and you can think about it and come to a conclusion later. Now with regard to the operating costs. I believe your estimate as contained in paragraph 5 on page 2 is broken down to two parts, the annual operating costs stated at $2,049.50 and annual administration expenses, $2,136.23. First of all with regard to the annual operating cost, am I right in saying that includes the cost of looking after the domestic line as well as the gathering lines?

A Yes, Mr. Hamilton, that would be correct. I treated gas lines as one head and crude lines as another and water lines as a third. Consequently you would be correct in assuming that the small, if any, costs of maintaining the domestic lines would be included in that.

Q My recollection is, you correct me if I am wrong, that the operation of your gas lines is attended to for you by field services of related companies, the Valley Oil Well Operators, is that it?

A Yes, that is correct.

Q And they have a force in the field who do the pipe walking, examinations and repairs and so forth and they bill you monthly or periodically at least with the costs of the service which they have rendered for you in regard to the pipe?

A That is correct.

Q And that related company, the Valley Oil Well Operators, has its own administrative staff I take it?

A It is a separate company.

Q It is a separate company, yes.

A The same clerical staff maintains part of the operations. That is the whole administration element is one.

Q When you receive a charge from this related company for looking after your gas line, that is a lump sum figure for gas lines and possibly another figure for crude lines and so forth, you just get a fixed charge based on the number of hours and the number of workmen and so on employed by the related company for your service during the month?

A Yes.

Q So that there is very little accounting, payroll work required insofar as Gas & Oil Refineries is concerned?

A That is correct, yes.

(Go to page 6301)

Q Now then that brings us to the consideration of the estimates made by you of the administrative expense and I am concerned to observe that the estimated administration expenses is over 100% of the estimated annual operating costs, and that relationship is quite at variance from that of the two companies. At least I will ask you to assume that. I would like to explore it. As I understand it you have determined the proportion of the administrative expenses to be borne by the gathering system as a function in investment in pipe lines as compared with total investment of the company in other assets ?

A I used that method, Mr. Hamilton.

Q Can you tell us what would be the total direct operating costs for say the nine months' period in 1943 or for any of the later twelve months' period, the total direct operating costs of the Company ?

A Of the whole refinery ?

Q Yes.

A I am afraid I have no evidence with me.

Q I have a figure of $290,343.12 as being the total operating cost exclusive of administration and depreciation for the nine months' period ending December 31st, 1943. Does that figure sound reasonable to you ?

A That I think would be correct.

Q If administration were 100% of operating costs that would suggest administration costs of $290,000.00 ?

A Using your method, yes.

Q Whereas the actual administration costs for that period as you give them here on Page 1, paragraph 4, were only $10,000.00. Have you given any thought to any other method of determining the fair proportion of administration to be charged to the gas

gathering system other than the pro-ratio on the basis of investment ?

A I did in submitting this give serious consideration to other methods, Mr. Hamilton, and discussions with others. I found that this would be the fairest way of arriving at the proper amount chargeable to this particular operation.

Q Have you in mind some peculiar feature of gathering operations which requires a relatively high proportion of administration expenses as compared to say running a scrubbing plant or compressor plant ?

A More thought has been given, Mr. Hamilton, by our executives to the question of gas wells than to any other part of our business in the last few years. Our gas throughput has been going down and our production manager, Mr. Mayland, our Managing Director, and the others have had to give very serious consideration to this asset of which we have a large investment which is depleting in value with a small throughput, and because of that extra effort we were able to make deals with several wells. We made a deal with the Royalite Oil Company, traded wells in the north end for wells in the south end, and were able to maintain the throughput on a fairly sound basis from 1943 on. Therefore I claim that the time of these executives should be proportioned to that asset in the proportion that that asset bears to our total investment. In other words, might I illustrate by taking say a Company having four units and they have their administration expenses of salaries, office rent and stationery, which cannot be directly allocated to either of these four units. At the end of the year they say, well how should we proportion our administration expenses. We have four units here. The obvious thing would be

to divide it by four, twenty-five percent each, or should one unit be more valuable than the others, then divide in proportion to that value. But not in proportion to the administration expense for this operation but total administration expenses. I claim that because of the good executive management we were able to keep down our costs to $2,000.00. The proportion as you mention of the others would mean not that our administration expense would go down, but that our operating expense would go up.

Q I take it that you consider administrative costs under two headings. One, to protect the investment, and the other, to run the operation for the period. Would that be a fair inference to draw ?

A I missed one word in your question.

Q (Reporter reads preceding question)

A Yes, that is correct.

Q In these deals you speak of exchanging wells and getting new contracts and so forth, the effect of that has not only been to provide throughput for the system but also to maintain the throughput for the absorption plant ?

A Oh yes, it follows down the line, surely.

Q Now you have a fairly large force of men working in the refinery and working in the absorption plant ?

A Yes, about eighty odd.

Q And there is a fair amount of payroll accounting required in paying those men and applying unemployment insurance and income taxes and so forth, and that type of cost does not apply to the wage costs of looking after the gathering line because you get a lump sum charged from Valley oil operators and the same applies to material expense which is supplied.....

A No, we supply the material.

Q Maybe so. I am not quite clear on that point. Well would you go this far with me and say that there are other ways that might be equally applicable of determining ?

A Absolutely. There are other ways certainly.

Q Now then Schedule "C" in determining operating costs. You have applied depreciation on a throughput basis as from the inception. That is from the 1st of April, 1943. Do you use that throughput method because you are aware that other parties to the Hearing have used it or because you personally subscribe to the throughput method as a fair basis of determining depreciation ?

A Partly both Mr. Hamilton. We explored the different methods of using depreciation and personally I preferred this method. I was aware, of course, that the others were also using this method.

Q Now then as an accountant and will you assume for the moment that Gas & Oil Refineries had never been incorporated, and that the assets we are now speaking of were still owned by Gas & Oil Products, and assume also that in 1934 when this gathering system was first instituted you had reasons to believe that the reserve gas available was on the order of 120 billion. Might you at that time, apart from tax considerations, have thought it fair to use a throughput depreciation formula for amortizing your gas line investment ?

A I think I can say definitely no.

Q It is fair now. Why was it not fair then ?

A We had no knowledge Mr. Hamilton of the reserves in 1934.

Q Oh I asked you to assume that you had reason to believe that the field reserve was 120 billions.

MR. MAHAFFY: I think Mr. Chairman this assuming business

is going too far. I think we had better stay to facts as I produced this witness to give you facts, not to theorize.

THE CHAIRMAN: I think what Mr. Hamilton is possibly doing is laying a foundation and he simply says to this witness if in 1934, if you had been familiar with the throughput depreciation method, if you had known the reserve amounted to so many billion feet would you then have thought of using the unit depreciation method instead of some straight line method ?

MR. CHAMBERS: I would like to subscribe to the position taken by Mr. Mahaffy and to object to this particular type of cross-examination of this witness in that he is being treated as an expert in asking for opinion evidence. Now, I am not doing this to be technical but I do suggest that this witness, until he has been examined as to his qualifications at least, should not be asked opinion evidence.

THE CHAIRMAN: Oh I think he has demonstrated his qualifications very efficiently in the last two days.

MR. CHAMBERS: He has definitely demonstrated his qualifications as to the knowledge of the business of the client he works for, speaking as to facts.

THE CHAIRMAN: And as an accountant. Surely Mr. Chambers you will agree he has done that ?

MR. MAHAFFY: My position, sir, I do think it is most unfair to the witness to cast his mind back twelve years. 1934, crude oil had not been discovered in Turner Valley. There was an absorption plant there. No refinery. As the witness has himself said the details of reserves were in a state of - even much more so now - of uncertainty. True there have been some dignified guesses given at a hearing of the Utilities Board in 1932 I think it was. But to ask the witness to express an

opinion based on so many uncertainties, I do not think it is fair to the witness and not of any help to you.

THE CHAIRMAN: I am not so sure of the latter, because Mr. Mahaffy it has been suggested by witnesses the proper way to treat the rate base and the building of the rate base is to take a certain phase of valuation and apply not to that observed depreciation but unit depreciation back to the days of construction. Now that evidence has been given and I assume Mr. Hamilton wants to know if this witness considers that a perfectly proper method.

A I am prepared to answer Mr. Chairman, assuming that I have knowledge of this method and assuming that I knew the available reserve to our Company, I would have been in favour of using that method of depreciation.

Q MR. HAMILTON: Well now come down to the point in time when this appraisal was made. I suppose it was a matter of common knowledge that the reserve tributary to your system so far as known was approximately two-thirds exhausted. Something on that order ?

MR. MAHAFFY: What was that question. I could not hear it.

Q (Reporter reads preceding question)

A No Mr. Hamilton, our Company was in the position at that time of looking for new wells, expecting new wells, financing new wells and we had every hope that we would be able to obtain sufficient raw production to bring our absorption plant back to normal capacity.

Q But you did know that your throughput had been drastically reduced ?

A On existing wells, but not on new wells not yet drilled or not

yet contemplated.

Q And you are down now to the point where at least operation is at 15% of maximum capacity so that so far as the operation then was leaving out of account for the moment the prospect of further expansion and improvements in efficiency and increment to supply and so forth,the operation was then down to a level substantially below that which had been obtained in 1936 or 1937. That would be true ?

A That is true leaving out the prospects of other wells which we were then exploring.

Q Then in so far as the supply that was or had been previously connected, the supply for which the lines were laid, that was known to be fairly well depleted at least to the extent of half or more. Would you agree with that ?

A No I would not, Mr. Hamilton. I can think of several wells that were attached to our system at that time, Calwin, Winalta, and Vanpeg, adjacent to the plant, new wells which were then almost at their peak in 1943.

Q But on the average though ?

A The old wells yes, but this Company was not established to simply process existing wells in 1934 and sit back. We are still financing wells in the hope we will be able to obtain further supplies.

Q And the extraction of the remaining thirty billion feet that is now suggested as having been the approximate reserve back in 1934, would be predicated upon the assumption that the absorption plant and refinery could continue to operate economically, otherwise the reserve would fall because there would be no one there to take the gas out ?

A It was operating economically and has continued to do so.

Q When I say economically I mean in the sense of being profitable.

A The combined operation, yes.

Q That is all.

(At this time an adjournment for fifteen minutes was taken)

(Go to Page 6309)

THE CHAIRMAN: Have you anything further, Mr. McDonald?

MR. McDONALD: No, except the same problem arises in the absorption plant.

THE CHAIRMAN: In the absorption plant?

MR. McDONALD: Yes.

THE CHAIRMAN: Is there any further cross-examination?

MR. STEER: I wonder if I might ask one question, sir?

THE CHAIRMAN: Yes.

....

CROSS-EXAMINATION BY MR. STEER.

Q I understand, Mr. Scrimgeour, that you did not submit a rate base here and ask for a return on a rate base?

A No, we did not, sir.

Q And what you say is that whatever price the Board fixes for gas at the outlet of an absorption plant, is the price that is to paid for your residue gas, is that so?

A That is correct. If it is rated at the absorption plant, we are assuming that.

Q Yes. Now, assume that the price that the Board fixes is at the outlet to the Madison scrubber, Mr.Scrimgeour, and suppose for the sake of argument that the Board fixes a price at 7¾ cents for gas delivered at the outlet to the Madison scrubber through which your gas has to go, is that right?

A That is correct.

Q Your proposition, as I understand it, would be that from that 7¾ cents price at the outlet of the scrubber, would be deducted the transportation costs between the outlet of your absorption plant and the outlet of the scrubber, and that is the amount of

money that should be paid to you?

A Yes.

MR. HAMILTON: And deducting the amount of the scrubbing costs.

Q MR.STEER: And deducting the amount of the scrubbing costs. Deducting all the costs of the operations that take place between the outlet of the scrubber and the outlet of your absorption plant from the 7¾ cents price, then that is the amount that should be paid to you, correct?

A Correct.

Q And when you get that amount of money you are going to add that to the proceeds of the sale of the products of your absorption plant, and then you are going to divide that whole sum between the absorption plant and the producers?

A That was my proposition, sir.

Q That is as I understand it?

A Yes.

Q MR.HAMILTON: Following that, sir, that would mean quite likely that the producer feeding into your system would receive a different amount per MCF for dry gas than if he fed into the Madison system or the British American system?

A Not until I knew the method that the Madison Company proposed to distribute the dry gas between themselves and their well operators. I would have to know that, Mr. Hamilton.

THE CHAIRMAN: It could mean that?

A Yes, it could.

....

CROSS-EXAMINATION BY MR. CHAMBERS

Q Mr. Scrimgeour, at the time your employer, this present Company, acquired this property in 1942, it did so on the basis of an appraisal, that is right, is it not?

A That is correct.

Q And that appraisal deducted from the estimated cost new, 30%, did it not?

A That is correct.

Q And am I right in this, that that 30% was deducted from the entire costs of both the materials and the labour of installing and everything?

A Yes.

Q Can you tell me why, if you know, your Company did not insist on the depreciation to be deducted from the estimated costs new being computed on the basis of, or in the ratio of the throughput that had gone through the plant prior to 1942, as applied to the total future over-all throughput?

A We had no knowledge, Mr. Chambers, at the time what the total throughput would be.

Q In 1942 you would have some estimate, would you not?

A You are referring not to crude oil, I presume? You are referring to simply the asset in this submission No. 1?

Q Yes?

A I should say, Mr. Chambers, that an appraisal was made of the refinery which included the original absorption plant and the gas gathering lines. It was not an appraisal of the absorption plant alone.

Q Well, as I understand it, your Company desired to acquire this property at a fair value?

A Correct.

Q Or not more than a fair value?

A Correct.

Q What I am wondering is, why your client or your Company did not insist on the plant being depreciated on the basis of the throughput that had gone through when it was owned by the old Company?

A I will answer that in this way, that we anticipated, and still anticipate bringing in further wells that might bring back our throughput to normal.

Q What do you say as to this proposition, and I am suggesting it to you and ask you for your reaction, that the value of that plant in 1942 to your company, and the purchase did not depend one iota on the amount of gas that has gone through in the past, what do you say as to that?

A I would say that is correct, sir.

Q Now, let me put this proposition to you, that the value, and I am asking for your reaction, that the value of it to your Company acquiring it depended a lot on the amount of gas that was still there to be handled. Would you agree with that proposition?

A Correct.

THE CHAIRMAN: Anything further? Thank you, Mr. Scrimgeour.

Will you give evidence now, Mr.Hamilton?

MR.HAMILTON: I could, Sir. I have distributed to Counsel certain exhibits which were prepared by us some year and a half ago referring to some of the matters that have been touched on today. I would be glad to go into the box and prove them.

THE CHAIRMAN: Factual material which you obtained from the books of the Company, is it?

MR. HAMILTON: Yes sir.

THE CHAIRMAN: All right.

....

ROBERT WINSLOW HAMILTON, recalled, having already been sworn, testified as follows:-

I am tendering these, Sir, four sheets dealing with Gas & Oil Products and Gas & Oil Refineries Limited, and I am suggesting that perhaps they might be incorporated as part of our earlier submission, being Exhibit 124, and with that in mind I have assigned each statement numbers W-H-65 to W-H-68, for convenience and reference. Would it be all right to deal with them in that way?

THE CHAIRMAN: Any objections from anyone to doing that?

Q All right, Mr. Hamilton.

FOUR STATEMENTS W-H-65 to W-H-68 INCLUSIVE, SUBMITTED BY R. W. HAMILTON, MARKED AS PART OF EXHIBIT 124.

A I might say when this information was prepared it was not intended to form part of our original submission, unless and until it became important to deal with the Gas & Oil Products and Gas & Oil Refineries, and that depended to some extent on what those companies themselves might propose to put forward, and there are, therefore, some refinements which we should have made had we known that the information was going to be presented. Statement W-H-65 is a depreciation table based on the volume throughput on a wet basis from 1934 through to 1943, and is predicated on an assumed remaining reserve at August 31st, 1944 of 31 billion feet. That estimated reserve fits fairly

well with the reserve which has been utilized by Mr. Scrimgeour as of September 1943...... 1942, pardon me.

If the volume throughput method of depreciation were, in the Board's judgment, to be applied retrospectively in valuing the assets taken over by Gas & Oil Refineries, then this table would reflect the approximate depreciation percentages applicable to assets acquired by the predecessor owner in each of the various years 1934 through '43. And if you should, of course, predicate it on that assumption, Statement #W-H-66 is a determination of the value of the gas gathering lines based on the gross appraisal less depreciation calculated on a throughput basis. The gross appraisal value is intended to be the same as that which I understand Mr.Scrimgeour has used in Exhibit 171. I notice that the terminal figures differ slightly, but not materially. The significant feature in my view with regard to this statement W-H-66 is the estimated depreciation applicable of $90,983.00 at December 31st, 1943, on gross assets of $257,000.00, as compared with the observed depreciation contained in the appraisal valuation of a flat 30%.

(Go to page 6315)

Statement W-H-67 is in parallel form to W-H-66 and represents a determination of value at December 31st, 1943, based on adjusted historical costs as closely as that figure can be determined, less depreciation to December 31st, 1943, on a throughout basis.

Perhaps I should at this point deal with this valuation for gross adjusted historical costs.

With the co-operation of Mr. Scrimgeour, some eighteen months ago I made an examination of the plant records of the Gas & Oil Refineries Limited, and the predecessor owner, Gas & Oil Products Limited, and attempted to abstract therefrom the historical costs of the assets in question.

Unfortunately two difficulties were encountered; the first being that the records of the Company did not reflect their historical costs of the gas gathering lines as such, but did contain an account representing the historical cost value of lines, including the gas gathering lines, dry gas delivery lines and crude lines, and we apportioned that total historical cost included in that combined account amongst these three classes of lines in the same proportion or in the proportion that the appraisal values of both classes bore to each other.

The second difficulty was that in our view, and I believe Mr. Scrimgeour concurred, there were a number of additions made to the physical plant in the form of gathering lines which had not been capitalized but which had been treated by the Company as a charge to current operations, and we attempted to reflect such adjustments as appeared to us to be necessary in order to arrive at what the capitalized value would have been had the Company been under regulation and had capitalized these things which I, myself, would have deemed proper to capitalize.

On the books of the Company the total capitalized costs of pipe lines, including all these classes to which I have referred, amounted to $93,412.72. That is before depreciation, and we considered it proper to add to that amount a further figure of $59,157.20, arriving at a total adjusted historical cost of all three classes of lines, of $152,569.92, of which we considered $119,542.66 to be applicable to gas gathering lines as at August 31st, 1944.

Those explanations are intended to account for the figure of $119,542.66 appearing as the total of the first column in Statement W-H-67.

I did not substract the related reserve for depreciation applicable to those assets because in my view the book depreciation was not of particular significance, although I have since come to appreciate that in the viewpoint of some parties to the hearing at least, that the book depreciation is of considerable significance.

Statement W-H-68 was an attempt to arrive at the cost of gathering gas, using certain assumptions for the year 1944.

The direct operating costs could not be isolated for gas gathering lines, but could be ascertained for gas, oil and domestic lines combined, and that figure averaged for the two years ending June 30th, 1942, which appeared to us to be normal, amounted to $6121.00, and in our combined views, that of Mr. Scrimgeour and myself, and I believe he concurred, 35% of that was taken as a fair estimate of that portion which was attributable to gas gathering lines, making the direct operating costs of gas gathering lines $2142.35.

You will observe that, in Exhibit 171 presented by

Mr. Scrimgeour, the operating cost of the gathering lines, including the domestic lines, was taken to be $2049.50, based on a more accurate analysis made for the year 1945, and consequently our estimate is some few hundred dollars higher than the more recent determination made by Mr. Scrimgeour.

With respect to administrative expenses we apportioned the administrative expenses to operating expenses, pardon me, we have apportioned the administrative expenses to the gas gathering system on the basis of the percentage of the total administrative costs of the Company to the total operating expenses of the Company, and found that the percentage of the administrative to direct operating costs was 8.4%, which applied to the two thousand dollars, $2142.35, of direct gathering line operating costs, yielded an additional amount of $180.73 to be allowed for administration. I would be inclined to think, perhaps, that that figure is low.

We then have added an allowance for depreciation based on cost values and based on throughput depreciation formula, the amount for 1944, for depreciation, would have been, under those assumptions, $9409.10.

Adverting for a moment to Statement W-H-67, dealing with historical costs, I would consider now that the Company would be entitled to a further allowance for overhead during construction of, you might say, 10%, with the result that those depreciation costs would be increased by a further 10%.

The sum of those three elements of costs shown on Statement W-H-68, gives the estimated costs of gathering gas of $11,732.18, for the year 1944, before allowing a rate of return, that is the cost of transporting wet gases, and there is yet to be made some allocation of that cost between the dry market and the absorption plant, if this matter is to be dealt

with in the same fashion as for the other two utility companies, and leaving aside for the moment the suggestions made here this morning.

Then the total at the bottom of the page, or Statement W-H- 68, we have attempted to include a rate per MCF wet, to be allowed to Gas & Oil Refineries as an operator of a gathering system, if it is desired to yield them the rate of return on the rate base at various percentages on the investment.

At 9% gross, before taxes, and continuing the assumptions which we have already made with regard to rate base, the rate per MCF wet would be .47 cents, and the remainder of that column shows the rate, the cents per MCF which would be paid to yield the various rates of return.

Once again, perhaps, I should emphasize that there would be two contributors to that, the absorption plant and the dry market.

I think, sir, that covers the salient points.

THE CHAIRMAN: Mr. Harvie?

MR. HARVIE: No questions.

THE CHAIRMAN: Mr. Mahaffy, I think perhaps it would not be fair to ask you to cross-examine right now unless you have had an opportunity of studying the statements prior to this morning.

MR. MAHAFFY: Well thank you, sir, However, Mr. Hamilton gave me copies of the statements yesterday at the adjournment and we have attempted to go over them yesterday afternoon.

....

CROSS-EXAMINATION BY MR. MAHAFFY.

MR. MAHAFFY: I have not really very much to add, Mr. Hamilton, but Mr. Hamilton, on your Statement W-H-67, - now as I understand this statement, it is just a cost valuation, the second column, those are the figures which you extracted from the records given you by Mr. Scrimgeour, being the actual costs to the Company of those installations?

A Plus very substantial adjustments which we felt were necessary to give what would have been the historical costs had we endeavoured to arrive at it under regulation.

Q Yes. Now then, I do not need to tell you that that figure of a hundred and nineteen thousand five hundred is substantially less than the appraised value made in 1943?

A About 40% I would say.

Q Yes. Now would you agree that the cost of installations had tremendously increased over that period, 1934 to 1943?

A Yes.

Q Would you agree that the costs of materials advanced substantially?

A Yes.

Q And also the costs of labour?

A Yes.

Q Now would you also agree or do you know, Mr. Hamilton, that there was a period in the Thirties when frequently there were what you might call "fire sales of pipe and other equipment in Turner Valley"?

A That is my information, yes.

Q And consequently if I told you that a good deal of the pipe that went into the cost in W-H-67 was bought at fire sale prices, you would agree that that would materially affe t the

cost?

A I would say it would, yes.

Q And would you also agree that all of these factors which you and I have been discussing could easily account for the difference between $119,542.00 and the appraisal figure?

A I would agree if you struck out the word "easily". I am not so sure......

Q You are not so sure of "easily", well, we will strike that out.

A It could account for it, yes.

Q It could?

A Yes.

Q Now turning to your Statement W-H-68, I am going to skip the first item because your figure is better for us than our own figure?

A That is correct.

Q There is not much difference in the two, but going to the second figure, administrative expense, . you heard what Mr. Scrimgeour has said this morning as to how he arrived at his figure for the administrative expense?

A Yes.

Q Do you think his method of computation is wrong?

A The method of computation is not wrong. It merely represents one approach to a determination of administrative costs, an approximation, and no matter what formula is used, it is bound to be arbitrary, because you have not got an isolated gas gathering system. You have a gasgathering system which is part and parcel of a larger undertaking.

Q Yes?

A And there is no system......

Q Excuse me, I did not mean to interrupt?

A I doubt whether there is any formula which is completely free

from attack, but it is certainly, I can see grave objections to using the investor factor alone as the criterion for the apportionment of the administrative costs.

Q I think you are fair enough to say that you were too low?

A Yes.

Q So perhaps would you agree it is not fair to use the formula alone which you adopted in W-H-68?

A Yes.

Q That is what you are getting at?

A Yes.

Q I suppose the only way that you could accurately divide those administrative expenses would be to put an accountant on the tail of each of the administrative officers and find out how much time each has spent in each portion of the work, would that be correct?

A And it would cost more than it would be worth.

Q Yes, so consequently, as an accountant, you have to consider the situation and then decide which one of perhaps several formulas you are going to use?

A Yes, and I would have regard to the results obtained perhaps by other operators, as being an indication of what would be fair.

Q Yes?

A And I should also add to that, that certainly the fact of the size of the operation would have a bearing too, because I am convinced that the smaller the operation the higher the proportion of administrative to operating costs.

Q Well, among other factors to be considered, to strike some sort of balance, would you agree that the factors that Mr. Scrimgeour described this morning should properly be taken into account, -

you recall he said that, as you know, that the gas available to this particular plant is rapidly diminishing and that the officers are kept busy to see what can be done, - to see what other wells can be connected, he mentioned contacts with the Royalite and so on, would you not consider those to be factors to be considered in splitting these administrative expenses?

A Yes.

Q You still feel, do you, Mr. Hamilton, that Mr. Scrimgeour's figure is too high?

A I think these are too high.

Q And you think yours are too low?

A Yes.

Q A figure somewhat in between perhaps would be the best accounting guess?

A Yes, and there is lots of room to move around in between the two.

Q Now then, we come to the next item, depreciation, and your figure there is slightly less than half of Mr. Scrimgeour's figure, I believe, - yours is ninety-four hundred and his is some twenty-one thousand?

A Yes.

(Go to page 6323).

Q Now in computing your depreciation Mr. Hamilton, you have taken the figure of $71,804.00 from your WH-67 ?

A Yes sir.

Q That is right* is it not and this is the figure which you arrive at from the total original cost of $119,542.00 ?

A Yes sir.

Q Which is the figure we were discussing a few minutes ago ?

A Yes sir.

Q And you knocked off depreciation for 1934 to 1943, resulting in your $71,000 figure ?

A Yes sir.

Q So that if it should be concluded that it is not proper to take the $119,000 figure and the $71,000 figure then, of course, your whole calculation on WH 68 would have to go by the board ?

A Yes sir.

Q Have you any criticism - mechanical criticism of Mr. Scrimgeour's depreciation figures, assuming we started on the basis of the appraisers' valuation. Have you any criticism to offer ?

A No sir.

Q So that the whole turn there is on the starting point ?

A Correct. I should remind you that there should be allowed in my view at least a further depreciation amount in consideration of the construction overhead that perhaps should have been allowed in WH 67.

Q Yes, that would increase your depreciation allowance I think you said about 10% ?

A Yes sir.

Q That is all, thank you.

THE CHAIRMAN: Mr. McDonald ?

CROSS-EXAMINED BY MR. McDONALD:

Q There is just one thing Mr. Hamilton, the valuation you have made is exclusive of the domestic gas pipe line ?

A Intended so, yes sir.

Q And just for the record on the WH 68 you have two items of depreciation. First is the gross throughput of 12.327758% of $71,000.00 and how do you arrive at this figure of $1,910,802.00?

A That is half 1944 throughput and it is to give recognition to an assumption that the 1944 additions of $8,482.63 were made at the mid point of 1944.

CROSS-EXAMINED BY MR. CHAMBERS:

Q Mr. Hamilton, am I right in this, on your Statement WH 67, you are recommending to the Board a rate base of $71,804.62 ?

A No sir.

Q You are just putting it in as a matter of information as to what the result is by taking the adjusted actual historical cost ?

A I might go further than that Mr. Chambers. First of all I believe that $71,804.62 the figure as at December 31st, 1943 might properly be increased by 10% for overhead during construction.

Q Yes.

A Then I believe that the resulting value would be a fairer opening rate base than the replacement cost now less observed depreciation for reasons we have discussed at some length.

Q Notwithstanding the fact that this Company paid an amount based on the appraisal of $204,441.95, a year before ?

A I do not think it has been made clear in evidence that was a cash consideration, and I am not so sure it was a transaction between strangers. I may be wrong in that.

Q Are those two matters that would influence it ?

A Why certainly.

Q Well now Mr. Scrimgeour says they were not controlled by the same shareholders as I understand it ?

A Pardon me, he said "Are under the same executive management, neither is". It does not read "was",

Q Let me put it to you this way. Have you any information which leads you to believe that the sale in 1942 was not a sale at arm's length ?

A I have a feeling it was not at arm's length.

Q You have a feeling ?

A Yes.

Q And based on that feeling you think that the opening figure in 1943 should be this $71,804 plus 10% ?

A Coupled with that feeling sir, is the information that I have been given that the consideration for the sale of the assets was not a cash consideration.

Q Even if it was not a cash consideration that in itself would not influence you would it ?

A Yes sir.

Q Suppose instead of getting one hundred thousand dollars they got other property worth exactly one hundred thousand. Have you made any study of the consideration they paid ?

A No sir.

Q But you have a feeling it was not a cash consideration and you are not sure it was one hundred cents on the dollar ?

A I would go this far if the Board felt that reproduction cost

new less observed depreciation should be adopted for the reason that was the price paid by the present owner, then I think it would be proper for the Board to enquire into the basis of the transaction; whether it was between strangers and whether it was a cash consideration. I have not made that study.

Q But as I understand it and I want to be fair even without that study, but merely on basis of suspicion and I am not putting it in a sinister sense you think that the initial figure should start in 1943 at $71,000 plus 10%, roughly that ?

A I think I said, Mr. Chambers, I was not recommending $71,000 plus 10%, but I did think in answer to your specific question that would probably be a fairer figure than the appraisal figure. I am not prepared to make a specific recommendation.

Q But when you say you think it would be fairer I would like you to give us your reasons why you think it is fairer ?

A I have attempted to do so but I think I reserved the right to make determination after knowing those additional facts which I believe are pertinent.

Q But you now say you think it would be fairer and you must have some reasons other than just the supposition ?

A Those two circumstances I quoted to you well or ill founded as they may be, was the basis of my off-hand suggestion to you that I thought this would be a fairer basis, but it is not a considered opinion.

Q And in any event a rate base set up on the basis of the documents that you have filed this morning is not based on any inspection of the property ?

A Oh no sir.

Q And it may be in poor repair or excellent repair so far as any

knowledge you have ?

A Correct.

THE CHAIRMAN: Mr. Steer ? Mr. Harvie ? That is all Mr. Hamilton.

THE CHAIRMAN: Now we will proceed with the other one, Mr. Mahaffy.

MR. MAHAFFY: We are ready to proceed.

HENRY B. SCRIMGEOUR, direct examination resumed by Mr. Mahaffy:

Q Now Mr. Scrimgeour will you go ahead with report No. 2 in exactly the same way as you did with report No. 1 yesterday.

REPORT NO. 2, GAS & OIL REFINERIES LIMITED NOW MARKED EXHIBIT 172.

A Report No. 2 is submitted by Gas & Oil Refineries Limited on the subject of absorption units, Hartell, Alberta, Capital Costs and Operating Costs. The Index and Introduction and explanations are Pages 1 and 2, and the following schedules are attached.

A. Apportionment of Appraisal between Absorption Units and Crude Oil Units.

B. Operating Costs of Gas & Oil Products Limited for the years 1935, 1936, 1937 before addition of Crude Oil Units.

C. Revenue account April 1, 1943 to December 31, 1945.

D. Operating statement from commencement of Gas & Oil Refineries Limited on April 1, 1943 to December 31, 1945, based on the assumption Absorption Unit is divorced from Crude Oil Operations.

E. Reconciliation of Wet Gas Intake with Dry Gas Output for 1945.

1. We beg to submit herewith Report #2 dated March 22nd, 1945, covering our Absorption Plant operations. In the preparation of this submission certain difficulties were encountered, due to our method of operating our entire Plant on a combined basis, which difficulties are outlined herewith, together with our solution and the results obtained.

2. Gas & Oil Refineries Limited was incorporated on April 1, 1943 and purchased from Gas & Oil Products Limited, the Absorption Plant and Crude Oil Refinery situated at Hartell, Alberta. The basis of the purchase price was an appraisement made by General Appraisal Company Limited of Vancouver, B. C. and dated September 21,1942. We operate our entire plant as one unit under combined operations, using the same General Plant to process Natural Gas and Petroleum Products originating from Crude Oil.

3. In order to arrive at a correct apportionment of Capital Costs between absorption units and crude oil units, it was assumed that the crude oil units were moved to another location and divorced from the appraisement, leaving the necessary Plant with which to efficiently operate the Absorption units. Schedule "A" attached hereto shows this apportionment. Gas Lines, being the subject matter of Report #1, have been eliminated in all calculations submitted under Report #2.

4. Prior to the discovery of crude oil in Turner Valley, the Plant operated by Gas & Oil Products Limited, was solely an Absorption Plant processing Natural Gas. We are therefore submitting operating costs as furnished to us by Gas & Oil Products Limited for the years 1935, 1936, 1937. We are informed by our Plant Superintendent that these costs would

be applicable to current operations of the Absorption Plant, with the exception of chemicals used in treating which cost would diminish with a reduced throughput. Wages, salaries, maintenance and supplies have all substantially increased since 1935/37 and an adjustment has been made to allow for such increased costs. We find that in 1937 average earnings per employee were $1,488.07, whereas in 1945 they had risen to $1,827.42, an increase of 22.8047%. The latest published figure of the Dominion Bureau of Statistics Cost of Living Index, shows an increase of 19.99% over the pre-war figure. We have therefore used an arbitrary increase of 20% to adjust 1935/37 operating costs to 1945 levels and calculations are submitted under Schedule "B" attached hereto.

5. Administrative Expenses have been apportioned to Absorption Plant operations in the ratio that Absorption Plant investment bears to total investment which is $464,332.41 divided by $1,412,829.77 or 32.8654%.

6. Working capital has been included in the final operating statement calculated at 8% of total operating expenses, chemicals and administration expenses.

I would like to interject there that I intended to take 1/8 but due to a miscalculation I took 8%.

THE CHAIRMAN: Making 12 ?

A Yes, making 12½% instead of 8.

7. Depreciation has been calculated on a throughput basis by dividing the reserves of wet gas as at April 1, 1943, as per Schedule "B" Report #1 of 37,298,310 MCF, into the capital costs of the absorption units after deducting the Gas Lines

Capital Costs which are the subject matter of Report #1. This results in a depreciation charge of 1.2449154 cents per MCF which has been applied to the declining annual throughput.

(Go to Page 6331.)

8. We have taken the figure of 15.8333% as the rate of return which we consider the Invested Capital should be entitled to earn. After deducting Income Taxes at 40%, this leaves a net of 9½% for our shareholders, which we consider fair and reasonable for an investment of this nature.

9. The results obtained in Schedule "D" operating statement show that it would be uneconomical to operate our Absorption Plant as a separate enterprise, having regard to the declining reserves of Natural Gas available for our Company. It is only by using combined operations and utilizing all utilities to process both Natural Gas and Crude Oil, that we are able to continue to operate the Absorption Plant. Our contracts with the Well Operators call for an apportionment of the total Recoveries at the Posted Field Prices of 80/20 and it is our intention, subject to the approval of the Board, to continue to honour these contracts, irrespective of the fact that the enterprise is uneconomical when considered separately. We submit therefore, that for the reasons above quoted, no change should be made in the Natural Gas Contracts now subsisting between this Company and the Well Operators.

Now, on the schedules shall I read all the figures or just explain them ?

THE CHAIRMAN: Just explain them.

A Schedule "A" is an apportionment of the absorption units as distinct from crude units. This schedule was prepared by our Refinery Superintendent and we have placed in the first column the total value, which is the appraised value made by the General Appraisal Company Limited. The second column is that portion of the assets which is applicable to the absorption

units. And the third column is the portion which should be applied to the crude oil units. These are carried forward to the final totals and from the absorption unit assets we have deducted the gas gathering lines and the domestic dry gas lines as being the subject matter of Report #1, resulting in a capital cost in the absorption unit of $464,332.41.

Schedule "B" is the operating cost of Gas & Oil Products Limited for the years 1935, 1936 and 1937. I have given you in the first column a description of the item of expenses, I have given you the three years. I total them and then take the annual average, and added to that annual average the 20% increase as suggested in my paragraph in the explanations which gives us an adjusted total of $74,441.45 as being considered the normal operating cost of the absorption plant as divorced from our crude oil operations. Down at the foot of Schedule "B" is a calculation on chemicals, showing the amount for 1935, 1936 and 1937, that has been divided into or by the annual throughput, resulting in a unit amount of 0.06470 per unit which would represent the cost of chemicals in treating.

Schedule "C" is our revenue account for the absorption gasoline for the years 1943, nine months, 1944 and 1945. The first column shows the metered volume at well-head of wet gas. The second column is the corrected G.P.M. test average for the year. The third column is the actual recoveries in gallons. The next column is the still gas which originates from crude oil and therefore should be deducted and not form part of the revenue for this submission. The next column is the net gallons, and then I have turned it into barrels. And then the second last column is our average price

per barrel. And the last column gives you the annual value of the recoveries of absorption gasoline, high vapor gasoline, recovered through our absorption plant.

And then Schedule "D", I have headed it as a comparative operating statement for 1943, 9 months, 1944 and 1945, based on the assumption that the absorption plant is divorced from crude oil operations. As the years are the same I can run down the nature of the expense. The first shows the annual throughput which is required in order to determine the quantity of chemicals. The next is the operating costs as per Schedule "B" carried forward and the calculation of the chemicals based on the throughput unit cost. The next is my administration expenses totalled for the year, and then the 32.8654% of the sum which is included in the year to which it applies. And then the working capital at 8%, then you have the total of the 8% amount calculated and brought out, and then 15.8333% applied to it as the earnings. And then the depreciation is taken at 1.2449154 per Mcf, and that is shown, and then we take the depreciation at the mid-year in order to arrive at depreciating or declining invested capital. I have reduced each year the invested capital by the amount of the depreciation and have taken in at the mid-year as being the normal practice in arriving at this figure, and by multiplying that by the earnings we get the total amount, so that we have total costs for 1943 of $162,642.40, for 1944 $196,558.67, and for 1945 $185,155.34, Bringing forward the revenue from Schedule "C" we find that we have a deficit in 1943 of $89,022.32, a deficit in 1944 of $80,697.05, and a deficit in 1945 of $90,762.66. Always assuming that the absorption operations are divorced from crude oil operations.

Then the last schedule, Schedule "E", is a reconciliation of wet gas intake with dry gas output. This is for the year 1945. The first column shows the month. The second, the metered volume, and the quantity of fuel that is used by the well for their own operations after it is metered. An arbitrary amount per boiler has been approved in the field and is applied to each well and they are deducted that amount for fuel used by themselves.

The next column gives you the net to the plant. And then we have used the tables in order to adjust wet gas or convert wet gas to dry gas. This is based on the tables supplied by the American Institution, Natural Gas Institution, I have not got the exact name in my head, which gives us therefore a net to account for for the year 1945 of 3,013,583 which I have called 100%. Now then, to the right hand of that figure we have first of all a share of the market at two cents or .0200 as we call it, showing the Mcf that we sold at that figure and the amount realized for the same. The next column shows the share of the market at .0063 cents, shows the Mcf and the amount realized from same. The next column shows the amount of storage in Turner Valley, the rate of which has been deferred.

I would like to interject here a slight error in my figures which does not change things but which was pointed out to me by the Madison Natural Gas Company. In the month of May 15,238 Mcf were stored in Turner Valley, and in preparing the statement I had included it as being conserved in Turner Valley. I had shown the total of 45,261. That should have been divided, 15,238 stored and 30,023 conserved. As neither of them have been paid for it does not alter this

statement. Then the next column shows the quantity of natural gas used in the absorption plant operation. The second last column shows the shrinkage and the flared. And the last column is simply a total of the amount accounted for, balancing with the last column in the left hand submission.

And then I have made a recap at the bottom showing that of the total dry gas available 56.30% has gone to the market, which is 1,696,704 Mcf, for which we have already been paid $25,226.61, which amount, by order of the Board, is in a Trust account awaiting division. The deferred amounts have not yet been set and are shown in volume only and not in money.

THE CHAIRMAN: Anything further, Mr. Mahaffy ?

MR. MAHAFFY: That is all, Mr. Chairman.

THE CHAIRMAN: Mr. McDonald ?

CROSS-EXAMINATION BY MR. McDONALD:

Q Will you just deal, Mr. Scrimgeour, with Schedule "E". I am not quite clear as to the meaning of the column "Dry Gas Percentage as per Table". Is that a deduction on account of recovered absorption gasoline ?

A That is a table, Mr. McDonald, which removes from the volume of wet gas the quantity of absorption gasoline resulting in a decreased volume of dry gas. These are the tables supplied by the American Institute of Natural Gas Association and also as incorporated in the contracts of the Royalite or the Madison Natural Gas Company.

THE CHAIRMAN: It is the shrinkage due to absorption processes ?

A That is correct, sir.

Q MR. McDONALD: Will you just turn to the third column from the right, "Absorption Plant Operations Mcf" 20.22%. Now, just what use has that gas been put to, what happened to that volume ?

A That is the quantity of gas which is required to operate and maintain the absorption plant.

(Go to Page 6337)

Q That is plant fuel?

A Plant fuel. At one time, Mr. McDonald, we used expensability, but that has been out since '44. The commencement of '45 we converted the whole plant to steam.

Q Well, now, when you say absorption plant operations, does that include refinery power?

A No sir.

Q Does it include fuel for the power plant, the electrical plant?

A No sir, for the absorption plant operations only.

Q Well, is it a case of a common power plant for the entire refinery installations, including the crude oil and the absorption plant?

A I think I should interject here, Mr. McDonald, to say that I am only an accountant.

Q Yes?

A The division of the quantity of natural gas used at the refinery is under the jurisdiction of our refinery superintendent, a qualified engineer, who makes these calculations for the accounting department monthly, and I am not qualified to answer the methods that are used by him as an engineer to determine these quantities.

Q Yes. But the division is made, I take it then, between the absorption plant operations, the crude oil refinery operations....

A Yes.

Q And market and shrinkage and flared gas?

A Might I say there that the quantity used by the refinery is accurately measured and is accounted for, and a cheque is prepared and deposited in the trust account for the amount which has been used in refining operations, and is included in the quantity at 2 cents per MCF.

Q That is the share of the market?

A Yes.

Q Now then, just following along the question of the use of the gas, in your revenue account, Schedule "C", do you indicate - you do not include any revenue from the crude oil refinery division in respect to power supplied or anything of that kind to them?

A Well......

Q What I am thinking of is this, that your boiler plant heats both installations?

A Correct.

Q And your generating plant, that is, if you generate your electricity, I do not know whether you do or not, provides electricity for both plants?

A Yes.

Q Now, have you anywhere in this statement an apportionment of either to the absorption plant for that type of cost or expense from the crude oil end, or have you a credit from the crude oil end for the power supplied from the other?

A Mr. McDonald, in my introduction I state that we use at the moment combined operations.

Q Yes, that is true?

A And no distribution is made or attempted to be made by us. We, therefore, asked the previous owners of the absorption plant to supply their audited operating statements, and we arbitrarily used these figures.

Q So that if you took your operations from 1935 to 1937, before the refinery was in operation, the crude oil refinery, the utility items, such as power and heat and steam, were provided to the Plant, the Absorption Plant?

A Yes.

Q Now at the present time have you, do you know if that installation has been increased considerably, since then considerably?

A Yes.

Q Considerably?

A Yes.

Q So that at the present time there may be, if it was revised far enough, a credit to the Absorption Plant operations for power and electricity supplied, rather for heating and electricity supplied?

A Not for power, Mr. McDonald. The division of the gas between absorption plant and crude oil plant is made by the refinery Superintendent, and takes that into consideration, the other utilities, light and power, I do not think have been applied to this, no, they have not been included in this statement.

Q The reason I mention that, Mr. Scrimgeour, is that the percentage 20.22% far exceeds the percentage allocated to the same use by the other two plants in the field.

A I think that is to be explained, Mr. McDonald, on account of our low throughput.

Q Your low throughput plus the excess capacity that you have installed and not really in use?

A Yes, that would be a fair statement.

Q Now take Schedule "C", Mr. Scrimgeour; do I understand that you deduct the still gas?

A Yes.

Q Now am I right that that is gas which is, which comes off at

some stage in the process in the refining of crude oil?

A That is correct.

Q And it is produced from the crude oil?

A Correct.

Q Is it then introduced into the absorption plant at the same place that the natural gas goes into the absorption plant?

A Yes.

Q Can you tell me roughly . . . . .

A Yes, it becomes in effect another well, Mr. McDonald.

Q Yes. Then it makes use of this, it makes use of all the installations in the absorption plant, just as if it was natural gas?

A Yes.

Q Then is there any reason why the revenue from that particular gas should be deducted from the compilation of the revenue of the absorption plant as a whole?

A It does not enter into the revenue in my estimation, of products resulting from natural gas.

Q Well now, just a moment, as a result of that gas there is what is called, on this three-year period, there are five hundred and fifteen thousand four hundred and forty-three gallons produced, which is just slightly more than 10% of the total gasoline recovery in the plant.

A Yes.

Q Now we are not dealing here with anything in the nature of gathering costs or anything of that kind; is that not a fair item of revenue to the plant, that is recovered by the use of the plant and it would not have been recovered without the plant?

A No, that is true.

Q Yes, and it may be too that if that gas is deficient say in

some of the qualities which go to make up the final absorption product, that it has acquired some of those characteristics of the final product from the actual gas and to that extent has decreased, as it were, the actual recovery allocated to the natural gasoline?

A The fact is that it increases, the G.P.M. test is very, very much higher than the ordinary well. I am not in a position to give the exact figures.

Q No?

A But I know from hearsay that still gas is considered very, very wet.

Q Well it is an item anyway that is recovered through the plant?

A It is recovered through the absorption plant.

Q Yes?

A Correct.

Q Now, Mr. Scrimgeour, dealing with, in Schedule "C", you set out the price per barrel of your gasoline product, $2.33 in 1943, 2.28 in 1944 and 1945, where did you get that price?

A That is the monthly, weighted, average price, Mr. McDonald.

Q For what, for the 26 pound product?

A For all products recovered from the absorption plant.

Q Yes, will you just pardon me a moment; am I not right that the 26 pound product in 1945 up until several weeks ago was $2.28?

A Yes, that was the posted price.

Q For the 26 pound?

A For the 26 pound, yes, but we recovered other products besides the 26 pound.

Q And by the combination accounts. . . . .

A Depending on the quantity you have a variable monthly figure.

Q And it averaged out to $2.28?

A That is the yearly average, weighted average price at posted field prices.

Q And that is the price posted by the Imperial Oil Company?

A Correct.

Q Now can you tell me, Mr. Scrimgeour, whether the Gas & Oil Refineries Limited have purchased at any time the 26 pound absorption gasoline from any outside source?

A No, not Gas & Oil Refineries Limited; the former company, Gas & Oil Products, I think at one time did make a small purchase outside of our own organization.

Q Yes. Have you any recollection of the transaction?

A No, it is probably 12 years ago. I have an idea that we imported some from Montana at one time.

Q Now if you would look at Schedule "D", we will take 1944, the total operating costs on the basis of a return of 15.8333% is $196,558.67?

A Yes.

Q And the revenue is $115,861.62; now that is the revenue as arrived at by making use of this posted field price of the Imperial Oil Company Limited?

A Yes.

Q Now you did not actually sell any of that product from which that revenue was obtained, did you?

A Yes, we did, Mr. McDonald, we sold a high vapour gasoline.

Q To?

A To the Royalite Oil Company.

Q And that was at what price?

A The posted field price.

Q And then the 26 pound product, the portion recovered, what did you do with that?

A That was used in our own refinery blending operations.

Q Now can you tell me how much of that $115,861.62 is revenue that you actually received in cash from the Royalite Company?

A That we received in cash from the Royalite Company?

Q Yes.

A I cannot offhand, Mr. McDonald. There are 12 calculations to examine.

Q Is there any relative proportion that you could give me an idea of now, I mean as much as 50% or 75% or what?

A Approximately 25%.

Q Approximately 25%, and that would be in the neighbourhood of $30,000.00?

A Yes. I am speaking now, Mr. McDonald . . . .

Q Purely from memory?

A From memory, without my working papers in front of me.

Q So that it would be fair to say then that the balance of the revenue allocated here, namely say $85,000.00, would be a charge against the crude oil refinery operations because that is where the product was used, finally I mean.

A It is accounted for by the refinery operations, the crude oil refinery operations.

Q Yes?

A Yes, that is where it is used.

Q That is where it is used?

A Yes, there is no money that passes between the two units, you understand.

Q I understand.

A We operate under the combined unit system, Mr. McDonald, combined operations.

Q Yes, and of that amount 80%, - there is a further charge on account of payments due to the producer, of 20%?

A Yes, our contracts call for 80 and 20, which we continue to

make, irrespective of the fact that we are losing money on this operation.

Q Yes, so that on the assumption that the Gas & Oil Refineries Limited incurred an expense to acquire absorption gasoline of the 26 pound product in 1944, of $196,000.00, plus the 20% of the value of the product paid the producer, would give you the total cost to the Gas & Oil Refineries Limited of that product?

A No, sir.

Q What?

A No, sir, those costs are based on figures submitted in the years 1935, 1936 and 1937. In no place in the submission have I said that our current operations are such.

Q Well then, can you tell me offhand whether your current operations are more expensive or less expensive than the figures you have there?

A I have no knowledge. We are making no attempt to break down costs between the operating unit and the refinery. The absorption plant is a very, very small part of our operations, one small unit, I gave the information before, 6%.

Q MR. HARVIE: Of the total?

A 6% of the total.

Q MR. McDONALD: Your absorption plant is 6% of the total?

A Yes.

Q But it is a necessary part of your refinery operation, is it not?

A Necessary to what, Mr. McDonald?

Q Necessary, the product recovered from your absorption plant is a necessary ingredient . . . . . .

A Oh by no means.

Q In your crude oil operations?

A No sir.

Q Well I mean that is another source of supply for this product?

A We do not require it. We can produce all our refined products without the addition of absorption gasoline.

Q In your refinery?

A In our refinery, yes.

Q Well now then, I am interested in that because it occurs to me that your refinery operations by absorbing the deficit as indicated in the submission which is made, is in fact paying much more than the posted field price for this absorption product?

A I think that would be a fair deduction, Mr. McDonald.

Q Yes?

A Yes.

Q Which leads me to believe that the posted field price is not, insofar as your operations are concerned at least, indicative of the value to the Gas & Oil Refineries of the product obtained.

A That is not a fair deduction. We are saddled with an absorbtion plant which is operating at 15% capacity. We are unable to do anything with it other than use it to the best advantage, which we are doing and by using combined operations, we are still in business but operated separately, divorce it from the crude operations and we would close it immediately.

Q Yes?

Q MR. STEER: That is combined with the refinery it is profitable?

A No, that is not either a fair deduction, Mr. Steer.

Q The combined operations of the absorption plant and the refinery yield a profit?

A Yes, joint operations are yielding a profit.

Q THE CHAIRMAN: And the profit would be larger if you did not have the Absorption Plant?

A Yes, provided that we could recover our capital out of the investment but if we are still saddled with the investment, no.

Q MR. McDONALD: So your story boils down to this, that the operation of the Absorption Plant is really a salvage operation?

A I do not agree with the word "salvage", Mr. McDonald.

THE CHAIRMAN: Partial recapture.

MR. FENERTY: It is for the benefit only of the crude oil producers.

THE CHAIRMAN: I think we will adjourn now, Mr. McDonald.

Now what have we for tomorrow when Mr. Scrimgeour is finished? I want to adjourn a little earlier than usual tomorrow if it can be done.

You have your Order, Mr. McDonald, for the South end of the field.

MR. McDONALD: We have one point still in regard to the Order which we wish to take up with Mr. Bailey.

THE CHAIRMAN: You will not be able to get him today.

MR. STEER: I have no cross-examination I think of Mr. Scrimgeour, sir, and unless somebody else has some lengthy cross-examination I think perhaps we ought to be able to finish with the witness in a minute or two.

THE CHAIRMAN: I had an idea of asking Mr. Hamilton to do something about this.

MR. STEER: Oh yes.

THE CHAIRMAN: Although I might ask a question or two now which might avoid doing anything about that.

Q THE CHAIRMAN: I suppose that your absorption plant,

Mr. Scrimgeour, is included in your submission at the valuation placed upon it by the appraisal company?

A Correct.

Q Less some depreciation factor?

A Correct.

Q Supposing I held that present-day costs were 30% higher than your historical costs and deducted that amount from your capital investment, 30%, and supposing I said "I am not going to allow you 15.23% but I am going to give you 10% and pay your own income tax after", would the difference that would result turn your deficit into an operating profit, I know perhaps that is not the proper way to say it.

A Well, sir, I am not claiming that we have a deficit in my submission. I am claiming that if the plant was operated separately on its own feet, it would have a deficit.

Q Yes.

A We are not claiming that there is a deficit today.

Q Not a deficit in the combined operations?

A No.

Q I realize that, but I have nothing to do with the refinery end at all. I can only deal with the absorption plant and taking your submission as it stands and with those assumptions, do you imagine that your shown deficit would be converted into an operating profit?

A I would have to make a rapid calculation but it would certainly help, sir.

Q I will tell you what we will do. . . . . .

A It would help out on the deficit.

Q I am going to ask you and Mr. Hamilton to get together and prepare a little statement predicated on my only allowing you 10% return on your investment and paying your own income taxes

and assuming that your present-day appraisal is 30% higher than historical costs and then let us see what the result will be, taking your other figures . . . . .

MR. HAMILTON: I am not sure what assumptions there should be.

THE CHAIRMAN: Take the present-day value less 30% and assume that that would be, the resulting figure would be the historical costs.

MR. HAMILTON: That is take the appraisal value less depreciation.

THE CHAIRMAN: The appraisal value as shown in the submission as I understand it, which is the appraisal Company's figure with the depreciation deducted, is that right?

A Yes, the 30% has been deducted in all these figures.

Q In other words, your figure is 668,000 less the wells. . . .

A 464,000.

Q 464,000 and now assuming that is 30% higher than the historical costs?

MR. HAMILTON: Very good, sir.

THE CHAIRMAN: And assuming the rate of return is 10% and you pay your own income taxes.

MR. CHAMBERS: Then we are going on tomorrow?

THE CHAIRMAN: Is there any further examination?

MR. McDONALD: I just have very little more.

MR. HAMILTON: I have a few points which will take a few minutes.

THE CHAIRMAN: If you are willing to wait, I am.

MR. STEER: I am.

MR. CHAMBERS: If we finish with Mr. Scrimgeour, would we be sitting tomorrow? Is there anything else to go on with?

THE CHAIRMAN: I do not know unless Mr. Hamilton goes on

with his statement respecting Royalite.

MR. HARVIE: Is he ready to go on?

MR. HAMILTON: I can go on at any time. I do not know how long it will take.

THE CHAIRMAN: I think perhaps we had better adjourn then because that should go in tomorrow.

MR. HARVIE: Yes.

THE CHAIRMAN: There is no time to do it today so we will sit tomorrow.

Did you want to go home, Mr. Steer?

MR. STEER: I did, that is what I was thinking about.

THE CHAIRMAN: Would you mind starting at 9.15 in the morning, does anybody object to starting at 9.15 in the morning?

MR. McDONALD: It is pretty hard.

MR. FENERTY: And I wonder if it is worth it.

THE CHAIRMAN: I know, but Mr. McDonald you see I am away from my office for three days or four days at a time, you have to think of me as well as yourself.

MR. McDONALD: We will do that, and that is quite all right.

THE CHAIRMAN: Then we will start at 9.15 tomorrow morning.

(The hearing was here adjourned to be resumed at 9.15 A.M. April 18th, 1946.)

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[illegible]

- [illegible] -

[illegible] I see the hypothesis as ...

MR. [illegible]: Is he ready to go on?

MR. [illegible]: I can go on at any time. I do not know how long it will take.

THE PRESIDENT: I think perhaps we had better adjourn because it is nearly 12 (?) tomorrow.

MR. [illegible]: Yes.

THE PRESIDENT: There is no time to do it today anyway at 4 o'clock.

Did you want to go home, Mr. Brannon?

MR. [illegible]: I did. That is what I was trying to [illegible]

THE PRESIDENT: Would you mind starting at 9.15? It would make three minutes difference to starting at 9.15 if we start...

MR. [illegible]: It is pretty cruel.

MR. [illegible]: And I wonder if it is worth it you see.

THE PRESIDENT: I know, but Mr. [illegible] you can then go from here three or four days at a time, you have got to think of me as well as yourself.

MR. [illegible]: We will do that, and that is quite all right.

THE PRESIDENT: Then we will start at 9.15 tomorrow morning.

(The hearing was there adjourned to be resumed at 9.15 a.m., [illegible] 1946.)

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